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BRITISH COLUMBIA RAILWAY COMPANY

BCR
GROUP OF COMPANIES

THREE YEAR PERFORMANCE PLAN

2001 - 2003

April 2001

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BRITISH COLUMBIA RAILWAY COMPANY

PERFORMANCE PLAN

2001 - 2003

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BRITISH COLUMBIA RAILWAY COMPANY

COMMERCIAL SENSITIVITY AND CONFIDENTIALITY

The British Columbia Railway Company is a unique, fully commercial Crown Corporation with all of its businesses operating in full competition with the private sector in a deregulated environment. This uniqueness was recognized by the Province when the British Columbia Railway Company was the only public body exempted from "Freedom of Information" legislation.

The BCR Group of Companies is extremely vulnerable to the risks of disclosing or publishing any commercially sensitive information, operational performance statistics or financial data. The public availability of such information could seriously undermine BCR's competitive position. Only consolidated, historical results are currently published in the BCR Group Annual Reports.

As a result, this public Performance Plan document does not provide specific information pertaining to:

- Financial forecasts
- Performance measures and targets
- Specific business strategies
- Information on matters of competitive intelligence

The release of such information would be extremely disadvantageous to the BCR Group of Companies by providing competitors with commercial intelligence. The results of this would be detrimental to BCR Group's competitiveness and commercial viability and, ultimately, harmful to the value of the enterprise to the Province.

BRITISH COLUMBIA RAILWAY COMPANY

INTRODUCTION

The British Columbia Railway Company, also referred to as the BCR Group of Companies, is comprised of two major business units: BC Rail and BCR Marine. For management purposes, financial information within the BCR Group is prepared on a business unit basis rather than on the basis of individual corporate or operating entities.

BC Rail is the historic founding company of the Group and the railway continues to be the core business unit. However, during development of BC Rail's first strategic plan in 1991, it was identified that the recently deregulated Canadian transportation environment and the weak economic outlook for northeastern B.C. coal posed significant threats to the ongoing viability of BC Rail. As a result, a strategy of diversification was adopted to lessen the company's dependence solely on the railway and its predominantly resource-based traffic of coal and forest products.

In 1993, BCR Group acquired Vancouver Wharves Ltd., providing diversification into the marine terminal business and a wider range of freight commodities. Located at the southern terminus of BC Rail, Vancouver Wharves made an excellent strategic fit in building an integrated transportation company. In 1998, Canadian Stevedoring was acquired, providing further diversification into high-growth container traffic and the handling of other non-resource manufactured goods. Canadian Stevedoring also provides geographic diversification with its main facilities on the south shore of Burrard Inlet and stevedoring services up and down the B.C. coast. In 1999, Vancouver Wharves and Canadian Stevedoring were combined for management purposes into the BCR Marine business unit.

Each of the two business units prepares individual strategic plans which are reviewed in detail with the companies' respective Boards of Directors. The most recent updates to the strategic plans were approved by the Board of Directors in December 2000.

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BRITISH COLUMBIA RAILWAY COMPANY

VISION

To be a strategic advantage to BCR Group customers.

MISSION

To build an integrated group of freight transportation companies.

VALUES

- A safe and healthy work environment
- A customer-focused, market-driven approach to business
- A creative, resourceful and entrepreneurial spirit
- Continuous improvement and innovation
- Operate profitably and achieve business targets
- Treat everyone in an honest, fair and respectful manner
- Reward and recognize achievements of individuals and teams

BRITISH COLUMBIA RAILWAY COMPANY

BCR GROUP OF COMPANIES

Environmental Scan and Strategic Issues:

Over the past several years, the BCR Group of Companies has successfully diversified its sources of revenues and earnings through the strategic acquisition of new businesses. In so doing, it has established its reputation among industry peers and earned the respect of the Shareholder for its ability to successfully integrate and turn around under-performing companies. The BCR Group has a solid reputation for being a well-managed group of companies in British Columbia.

In addition to the payment of dividends to the Province, the BCR Group creates value for the Shareholder in a number of ways. Perhaps the most important contribution is through investing in major capital infrastructure projects which increase the enterprise value of BCR and improve longer term shareholder wealth. In addition to improving the value of the company, BCR Group's investments create employment opportunities in B.C.

As a fully commercial and competitive crown corporation, the BCR Group does not place any demands on public taxpayer funds while, at the same time, the company operates a profitable enterprise and invests substantial capital for its growth and diversification.

Through the Group's strategic planning process, the Board of Directors has identified three key strategic issues which involve participation of the Shareholder. These are:

- The need to restructure BCR Group's debt
- The need to establish a consistent, commercial dividend policy
- The need to decide on the future of unprofitable passenger services

Due to Crown ownership, BCR has not been able to source any new equity capital. All growth capital, beyond that provided by earnings, has been financed with debt through the Province. As a result, BCR Group's long term debt level has now grown to 111% of equity. A comparable transportation company would typically have a debt/equity ratio in the range of 30% to 40%.

As a result, BCR requested the Province to restructure its debt through a $350 million swap of equity capital for debt on the books of British Columbia Railway Company. This will result in BCR's capital structure being more appropriately aligned with others in the railway industry, and will allow the company to be self-sustaining throughout all phases of its business cycle.

Accompanying the re-capitalization of the BCR Group, a commercially responsible dividend policy also needs to be developed between BCR's Board of Directors and the Province. The new policy should balance the Province's requirement for dividends with the Group's free cash flow and its need to retain cash to provide for a cushion against unforeseen circumstances and opportunites.

The Province will also need to review the future of mandated, unprofitable passenger services operated by BC Rail. These non-commercial services, operated for purposes of public policy, are increasingly reducing the vital cash flow required by BC Rail to sustain its physical plant for commercial freight operations. This is discussed in more detail as one of the strategic issues for BC Rail.

Major Capital Project Information:

Within the period of 2001 to 2003, no major capital projects (requiring commitments in excess of $50 million) have been planned by the BCR Group of Companies.

However, preliminary evaluation is underway for a phased expansion of container capacity at BCR Marine's Casco Terminals. Capital cost for this project is estimated to be in the order of $50 million, yielding a potential 30% return on investment before borrowing costs and taxes.

Environmental Scan and Strategic Issues:

The continued effects of a deregulated Canadian transportation industry have stimulated many competitive factors that challenge the viability of BC Rail. The effect of these factors is now being intensified through the ongoing consolidation within the North American railway industry. With CN Rail continuing to grow in size and influence, BC Rail is particularly affected by the fact that its only direct interconnection is with CN.

In its role predominantly as an originating carrier, one of BC Rail's strategic strengths has been its ability to negotiate favourable rail routings and rates amongst a variety of rail carriers competing for the traffic to its end destination. The proposed merger between CN and BNSF created considerable concern as it would have been detrimental to the competitive position of BC Rail and its major customers. The combined CN/BNSF network would have greatly reduced the routing options by which B.C. products could access certain market regions in the U.S., and would have increased pressure on BC Rail's freight rates. Within the Canadian regulatory environment, the issue of shortline and regional railways being able to have competitive access, meaning the ability to interconnect with more than one major railway network, is a key issue in the current review of the Canadian Transportation Act. Uncertainty also exists in the U.S. environment as the temporary "moratorium" on mergers by Class 1 railroads (precipitated by the proposed CN/BNSF merger) will expire in June 2001.

Domestically, as a result of deregulation, competition between transportation modes, particularly by trucking, has triggered severe industry-wide freight rate erosion. Since deregulation in 1987, BC Rail has experienced a 40% decline in its average freight rate yield, as measured by Revenues per Gross-Ton-Mile. Unlike the trucking industry, railways are burdened with a high ratio of fixed costs and are responsible for all of their own capital investment in the transportation infrastructure. As a result, cost reduction in the face of severe revenue erosion is a major challenge for the entire railway industry.

Global competition and market volatility for B.C. commodities carried by the railway is also challenging the railway's ability to plan for and respond to customer needs. The current trend started with the economic turmoil and currency declines experienced by key Asian customers starting in late 1997. The resulting worldwide surplus production capacity and sharp price declines for many basic commodities placed higher cost producers, such as those located in B.C., at a serious competitive disadvantage.

In particular, B.C.'s forest products industry has been experiencing considerable turmoil amidst intense competitive pressures. Over the past several years, BC Rail has experienced erosion in its lumber traffic due to the closure and consolidation of several

forest product mills in the interior of the Province. In several cases, BC Rail has been pressured by customers to provide rate concessions to help keep their products competitive.

Following expiry of the Softwood Lumber Agreement, there is heightened uncertainty regarding the future volume of B.C. lumber exports to the U.S. It is anticipated that the U.S. will impose some form of Countervail Duty but, to date, the magnitude of such a duty is the subject of considerable speculation. In this environment of uncertainty, the potential negative impact to BC Rail's lumber customers cannot be known, but some mill closures and consolidations are likely. In response to this threat, BC Rail is preparing contingency plans, based on various scenarios, to mitigate the significant potential risks to its lumber traffic volumes and freight rates.

Another near term threat facing BC Rail is the loss of all northeast coal traffic by June 2003. Coal, moved in efficient unit trains, is a high contribution commodity and the loss of coal revenue has drastically reduced BC Rail's cash flow and operating income. A core element of BC Rail's strategic plan has been to develop and add replacement traffic through increased market share of other existing commodities and by securing whatever new traffic becomes available within the railway's service region. Unfortunately, the time horizon for implementation of this strategy was radically shortened when the Quintette coal mine closed in August 2000, removing two-thirds of BC Rail's remaining coal revenue almost 3 years earlier than expected.

As recently as 1997, coal accounted for more than 19% of BC Rail's revenue base. In 2001, it will be only 3.6%. By 2004, when all existing northeast coal traffic has ceased, it is forecast that 73% of BC Rail's revenue traffic will be comprised of forest products – an alarmingly high dependency on a single, highly cyclical commodity group.

The productivity of the entire railway operation must continue to improve through cost reductions and other initiatives to achieve an acceptable operating ratio in the face of declining revenues. While BC Rail has made impressive productivity improvements over the past decade, it has not kept pace with cost cutting initiatives at CN and CP Rail and this represents a growing threat to BC Rail's traffic base. Furthermore, the pace of cost cutting at BC Rail has not been able to stay ahead of the shrinking net contribution from revenue freight traffic. This challenge is heightened by the fact that most replacement, non-coal traffic forecast over the planning period will typically yield a lower contribution margin than coal while, at the same time, additional infrastructure expenditures will be necessary to create the capacity needed to carry that lower margin traffic.

Operating in uniquely challenging and high cost terrain, BC Rail also faces the need to maintain a capital-intensive, high quality physical plant. While continued cost reduction and productivity improvement initiatives are necessary, the integrity of the physical plant and safety levels must be maintained. This is becoming increasingly difficult to achieve as BC Rail's cash flow erodes, yet annual sustaining capital requirements are in the range of $60 million to $80 million per year. As a result, BC Rail could be faced with

increasing its debt levels to finance its sustaining capital programs, with a resulting reduction in any ability to fund growth initiatives.

The cash flow crisis at BC Rail is made worse by the costly obligation to operate unprofitable, passenger train services. In 2000, the operating losses from these passenger services consumed 2.5% of freight revenues. A further challenge is arising as the equipment used in these services is rapidly approaching the end of its service life and requires substantial capital investment if these operations are to continue. In 2000, it became necessary to remove the Royal Hudson steam locomotive from service indefinitely until its boiler and firebox could be rebuilt. BC Rail has recently been directed by the Province to commence work on rebuilding the Royal Hudson with no funding from the Province, despite this being an uneconomic passenger train service.

To deal with the above challenges, BC Rail's strategic business plan continues its focus on two key goals.

Goals and Key Strategies:

Goal 1. Increase Freight Transportation Revenues.

Key Strategies:

- Improve market share with existing customers and regain former customers through customer-valued service improvements and strategic pricing initiatives
- Win all new traffic opportunities which develop as a result of third party investments within BC Rail's service region
- Expand geographic reach and service offerings, including the use of electronic commerce

Goal 2. Improve the Productivity of BC Rail's Human Resources, Fleets of Rolling Stock and Facilities.

Key Strategies:

- Improve asset utilization through integrated transportation planning
- Implement new technologies to support reductions in unit transportation costs
- Focus on safety, quality and value
- Consolidate facilities and focus on core functions and operations
- Reduce overhead and administration costs through investments in information technology

Goal 3. Allocate Resources to Services Yielding the Highest Returns.

BRITISH COLUMBIA RAILWAY COMPANY

BCR MARINE

Environmental Scan and Strategic Issues:

The general trend on commodity prices continues to be downward, putting more pressure on all stakeholders in the logistics chain to cut costs and increase productivity. Many of the markets in which BCR Marine operates are mature and volumes through the Port of Vancouver, with the exception of containers and specialty agri-products, are expected to remain relatively flat at best.

BCR Marine's competitors are no longer only in Vancouver or even the Pacific Northwest, but in other parts of the world (especially in South America and Asia) where low-cost production facilities (mines, pulp mills, etc.) are coming into production at costs lower than domestic B.C. producers. In this regard, BCR Marine shares the risks of BC Rail with its forest product traffic base. Increasingly, BCR Marine's operations are subject to more stringent environmental regulations, monitoring and enforcement, and the escalating pressures of urbanization are limiting the waterfront land use and expansion possibilities on Burrard Inlet.

With BCR Marine's new structure and larger size, having combined the operations of Vancouver Wharves and Canadian Stevedoring, the company will be better able to create efficiencies, increase productivity, offer a wider range of services, and help customers be more competitive. The company's diversity gives it staying power, enabling the organization to take advantage of new opportunities as they emerge. BCR Marine's various business units are well positioned as either number one or number two in their respective markets served, and they have interests in two of the major growth markets in the Port of Vancouver - containers and specialty agri-products.

BCR Marine has recently invested in a dry-bulk handling facility and loop track system at the Vancouver Wharves site. This installation has significantly reduced handling costs and improved efficiencies. The investment also included a state-of-the-art handling system for specialty agri-products. A key challenge for BCR Marine is to attract sufficient volumes of specialty agri-products to yield the targeted return on investment.

Under the new commercial mandate of the Vancouver Port Authority, site tenants are required to invest their own capital in facilities. BCR Marine has successfully negotiated long-term tenure and related agreements with the VPA to secure the future of Casco Terminals and support capital investment. In response to tremendous growth in container traffic, and with the new VPA agreements now in place, BCR Marine is proceeding with a phased investment in its Casco Terminals' facility. The first phase consists of a site

reconfiguration to improve operating logistics and throughput productivity. The second phase will significantly expand overall container capacity.

In addition, BCR Marine is presently negotiating commercial terms for a renewed agreement with the Prince Rupert Port Authority for the operation of the Fairview Terminal. The current operating agreement will expire in 2002.

Over the next three years, BCR Marine is poised to become a major contributor of growth for the BCR Group of Companies, helping to offset some of the declines faced at BC Rail due to the loss of northeast coal and threats in the lumber industry. BCR Marine expects to accomplish this growth through the following key goals.

Goals and Key Strategies:

Goal 1. Set the industry standard for customer service excellence.

Key Strategies:

- Target specific customers and provide value-enhancing services in related areas to enhance their business opportunities
- Maximize quality assurance through improved customer-service training and ISO or other appropriate quality assurance programs
- Provide technological enhancements to improve customer service
- Rationalize and reconfigure facilities / agreements to increase container capacity

Goal 2. Have the best trained, most highly motivated people in the industry.

Key Strategies:

- With each employee, complete succession planning linked to career discussions, performance evaluations, and continuous upgrading of skills and education
- Provide a competitive compensation and benefits package
- Play a continuing leadership role in improving waterfront labour relations

Goals and Key Strategies: continued

Goal 3. Exceed all prevailing environmental standards.

Key Strategies:

- Develop an Environmental Management System based on a rolling five-year plan
- Participate proactively with regulators and industry in the development and enforcement of regulations

Goal 4. Achieve and maintain maximum Worker's Compensation Board merit ratings.

Key Strategies:

- Lead and support industry-wide safety initiatives
- Ensure adequate training for handling commodities with safety considerations
- Pursue strict accident investigation procedures and a performance recognition program

Goal 5. Enhance competitiveness by continuous improvement.

Key Strategies:

- Improve use of under-utilized facilities, land and resources via rationalization within and among facilities
- Develop common administrative processes across BCR Marine
- Explore opportunities to improve productivity and processes, and selectively employ capital to reduce costs
- Improve workforce effectiveness

Goal 6. Grow financial returns to meet or exceed shareholder expectations.

Key Strategies:

- Evaluate new opportunities with a disciplined approach with the objective of attaining the targeted return on capital invested
- Negotiate a commercially viable long-term contract with the Prince Rupert Port Authority for Fairview Terminal